

**Office of Chief Counsel  
Internal Revenue Service  
Memorandum**

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to: Alan Bruckner  
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subject:

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

Company A =

Company B =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Year 5 =

Year 6 =

Year 7 =

N1 =

N2 =

N3 =

N4 =

N5 =

N6 =

### ISSUE

Whether the Service may determine an intentional disregard penalty under Section 6721(e) against Company A for failing to timely file information returns for Year 5?

### CONCLUSIONS

Yes, the Service may determine the intentional disregard penalty under Section 6721(e) against Company A because the facts suggest it knowingly or willfully failed to timely file information returns with the Service for Year 5.

### FACTS

Company A is Form 1099 filers in the United States. Company A executes trades for , , and . For Year 1 through Year 4, Company A's filings increased from approximately N1 to approximately N2 Forms 1099. For Year 5, the filing almost quadrupled to approximately N3 Forms 1099. In March of Year 7, Company A filed approximately N4 Forms 1099 for Year 6, almost triple the prior years filing. For Years 1 through 5, Company A exhibited a pattern of late and inaccurate filings. The Service, however, has not previously contemplated an intentional disregard penalty for this taxpayer.

#### Year 1 & Year 2

Company A was formed in Year 1 during which it acquired Company B. Both companies catered to and were required to file millions of Forms 1099. For both years, Forms 1099 were late filed under both company names although they should have been filed solely under Company A's name, address, and TIN.

The Service sent a Notice 972CG, Notice of Proposed Penalty, to both Company A's and Company B's last known address for Year 1 and Year 2. The Service received no response from Company B as it had ceased operating from the last known address used by the Service. Company A, however, responded to the Year 1 and Year 2 notices by letters explaining why the Forms 1099 were filed late. The reasons included computer problems at both Company A and the Service's FIRE unit in Martinsburg. Company A stated that "[t]he personnel at [Company A] have made the proper resource and system commitments after the [Year 1] filing to ensure that the [Year 2] and future years Form 1099's will be submitted in a timely fashion." Despite this statement, Company A's Year 2 filing was rejected due to improper formatting and the corrected filing did not occur until September of Year 3. Nevertheless, the Service waived the penalties for both years.

### Year 3 & Year 4

For Year 3 and Year 4, the Forms 1099 were again late filed under both Company A's and Company B's names. For both years, Notices of Proposed Penalty were sent to Company B at their former address and no response was received. For Company A, a penalty notice was not generated for Year 3 and we are unsure why. For Year 4, Company A was granted a filing extension within which it timely filed.

### Year 5

In October of Year 6, Company A electronically filed approximately N3 Forms 1099 with over N5 errors. Company A claims to have requested an extension although this has not been verified. Regardless, the filing was approximately four months after the deadline, including any extensions, rendering all N3 Forms 1099 late filed. Since Company A is filers in the United States, Martinsburg personnel were aware of the non-filing and contacted Company A via phone and e-mail to inquire as to their anticipated filing date. In addition, a computer generated letter was sent on July 7 of Year 6, stating that Company A had not yet electronically filed its Year 5 Forms 1099.

On November 20 of Year 6, an Employment Tax Specialist met with executives of Company A regarding this matter. Company A provided no explanation for the late filing. On January 7 of Year 7, Company A, through counsel, submitted a memorandum opposing the intentional disregard penalty by explaining that the failure to timely file was "attributable to the enormous unanticipated growth in trade volume, and do[es] not reflect anything 'intentional,' nor any 'disregard' of [Company A's] obligations."

## LAW AND ANALYSIS

Section 6721 provides for a penalty when an information return is not timely filed. Under the general rule, the penalty is determined based on a sliding scale. The amount increases based on the lateness of the filing and is capped at \$50 per failure, not to exceed \$250,000, for returns filed after August 1. Subsection (e) provides for an uncapped penalty based on intentional disregard when it can be shown that the taxpayer knowingly or willfully failed to timely file the information returns. Treas. Reg. § 301.6721-1(f)(2). The intentional disregard penalty for late filing Form 1099 information returns is 5% of the aggregate amount of the items required to be reported.

Whether a taxpayer knowingly or willfully fails to timely file an information return is "determined on the basis of all the facts and circumstances in the particular case." *Id.* Some of the factors to consider in making the determination are stated in Treas. Reg. § 301.6721-1(f)(3) and include:

- (i) whether the failure to file timely is part of a pattern of conduct of repeatedly failing to file timely;
- (ii) whether a correction was promptly made upon discovery of the failure;
- (iii) whether the taxpayer corrects the failure to file within 30 days of a written request from the Service to file;
- (iv) whether the failure to timely file penalty is less than the cost of timely filing.

The first factor weighs in favor of finding intentional disregard. Since Year 1, Company A has exhibited a pattern of repeatedly failing to timely file its information returns. The Service waived proposed penalties for Years 1 and 2 after Company A showed that it had reasonable cause for the failure to timely file and assured the Service that remedial measures were taken to ensure future compliance. These remedial measures were apparently not taken or were inadequate as evidenced by Company A's subsequent late filings. In addition, Company A improperly filed millions of late Forms 1099 for Years 1 through 4 under Company B's name, address, and TIN as a result of inadequate verification and oversight.

The second and third factors also weigh in favor of finding intentional disregard. Company A was contacted by personnel from the Service's Martinsburg FIRE division via e-mail beginning in May of year 6. An IT Specialist sent Company A e-mails on May 2, May 13, and August 22 inquiring as to when Company A would be ready to transmit its Forms 1099. In addition, a computer generated letter was sent on July 7 of Year 6 informing Company A that the Service had not received its Forms 1099 filing for Year 5. Company A ignored these contacts and filed its information returns in October of Year 6, more than 5 months after the May 2nd e-mail and 3 months after the July 7th letter. Furthermore, Company A was aware of the filing deadline as evidenced by its prior correspondence with the Service regarding prior tax years and its claimed extension request for Year 5.

Finally, the fourth factor weighs in favor of finding intentional disregard. Upon being informed that the Service was considering the intentional disregard penalty for Year 5, Company A took the steps needed to timely comply with its filing obligation for Year 6. Year 6 had a three-fold increase of approximately N6 Forms 1099. The fact that Company A was able to timely file after experiencing such a large increase in volume strongly suggests that Company A could have timely filed the Forms 1099 for Year 5 and the prior years had it dedicated the necessary resources. Company A's repeated excuse for the late filing in Years 1 through 5 due to "enormous unanticipated growth" appears to lack merit and its repeated late filing due to insufficient resources appears to be attributable to a financial decision.

In addition, Company A has stated that it provided its clients with timely Forms 1099 every year even though it was unable to timely report to the Service. This suggests that the information was available and that Company A was able to print and timely mail millions of Forms 1099. These actions strongly suggest that Company A could have but

chose not to expend the resources necessary to timely file with the Service. In light of the fact that the Service had not imposed any penalty on Company A for Years 1 through 4, it can be inferred that they weighed the cost of timely filing with the Service against the potential penalty and decided against the expenditure. Likewise, it can be inferred that Company A believed that the cost of losing customers due to late mailings of Forms 1099 was considered greater than the cost of ensuring that its customers timely received their Forms 1099.

We concluded that all four factors weigh in favor of a finding of intentional disregard. Company A repeatedly filed information returns well past the filing deadline. Company A was aware of its obligation and did not act to fulfill it. The evidence suggests that this was a conscious business decision. The Service may, therefore, determine the uncapped intentional disregard penalty for Year 5 against Company A pursuant to Section 6721(e).

#### CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]



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Please contact Ronald J. Goldstein at (202) 622-4910 if you have any further questions.